No. 644

In the Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CEMENT INVESTORS, INC.

PETITION FOR REHEARING ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

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Comes now the Solicitor General, on behalf of the petitioner, and respectfully prays for a reconsideration by the Court of its order of February 9, 1942, denying certiorari herein.

This petition is filed (a) because the disposition of the case is inconsistent with the decision on February 2, 1942, in *Helvering* v. *Southwest Consolidated Corp.*, No. 286, and (b) because of the confusion and uncertainty which thereby have been created in the administration of the revenue laws.

This case involves a plan of reorganization adopted in 1936 in a proceeding under Section 77B

of the Bankruptcy Act. The debtor was The Colorado Fuel and Iron Company. The taxpayer owned certain of its bonds.[1]

Under the plan, the corporate assets were transferred to a new company. In return, the latter issued new income mortgage bonds and shares of common stock, which were distributed in exchange for the old bonds, and stock purchase warrants, which were distributed in exchange for the old stock.[2] The question is whether gain should be recognized upon the taxpayer's exchange of the old bonds for new bonds and stock.

This case was one of the group of test cases brought by the Government in order to obtain authoritative determinations respecting the tax consequences of creditor reorganizations of insolvent corporations. This end was substantially achieved with respect to transactions arising under the statutes prior to the Revenue Act of 1934, c. 277, 48 Stat. 680, although adversely to our contentions, by the decisions on February 2, 1942 in *Helvering* v. *Alabama Asphaltic Limestone Co.* and *Palm Springs Holding Corp.* v. *Commissioner,* Nos. 328

[1] The proceedings also involved The Colorado Industrial Company, a wholly owned subsidiary of The Colorado Fuel and Iron Company. The bonds referred to were originally issued by the subsidiary, but were unconditionally guaranteed by the parent both as to principal and interest. Virtually all of the assets of the subsidiary had been taken over by the parent in 1913.

[2] The new company also assumed the obligations upon an issue of general mortgage bonds.

and 503, respectively.[2] Similarly, the decision on the same day in *Helvering* v. *Southwest Consolidated Corp.*, No. 286, resolved the question with respect to transactions governed by the reorganization definition of the Revenue Act of 1934 and later statutes.

It was believed that the Court was withholding action on the petition for certiorari in this case until after its decisions in the group of cases already before the Court, and that this case would be disposed of in accordance with those decisions. The disposition of this case, however, appears to be inconsistent with the result in the *Southwest Consolidated* case, and has produced new uncertainty. It is important in the administration of the revenue laws that the situation be clarified.

1. The two cases arose under identical statutory provisions, and their facts correspond in all essential particulars. The ultimate issue in the *Southwest Consolidated* case was whether the basis of the assets in the old corporation was carried over to the new, whereas the ultimate question here is whether gain should be recognized upon the exchange of securities of the old corporation for securities of the new; but that ultimate issue in each case pivots upon whether there was a "reorganization" within the meaning of the statutory defini-

[2] Cf. *Bondholders' Committee, Marlborough Investment Co.* v. *Commissioner*, Nos. 128–129, decided the same day in favor of the Government on the basis of particular distinguishing facts.

tion, and that definition is identical in the Revenue Acts of 1934 and 1936, the statutes involved in the two cases. See Sections 112 (b) (3); 112 (g) (1); 113 (a) (7). In both cases, the stockholders of the old corporation received only stock purchase warrants in the new company; their interests were otherwise eliminated. In the *Southwest Consolidated* case, the new company, in return for the assets, issued warrants and paid cash, in addition to its common stock; here, the new company issued warrants and new bonds as well as common stock.[4]

In the *Southwest Consolidated* case, the Court held that the transaction was not a reorganization within the definitions set forth in Section 112 (g) (1) (B), (C), (D), or (E) of the 1934 Act and that therefore the old basis would not carry over under Section 113 (a) (7). The opinion, moreover, expressly pointed out the error of the court below in its conclusion that there was a reorganization here under Section 112 (g) (1) of the 1936 Act.[5] Thus, to the extent that the decision below rested upon the statutory definition of reorganization, it

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[4] While the transaction in the *Southwest Consolidated* case was effected in a receivership proceeding, and in the instant case, in a proceeding under Section 77B of the Bankruptcy Act, this difference in the "procedural devices" employed to carry out the plan cannot be material. Cf. *Helvering* v. *Alabama Asphaltic Limestone Co.*, *supra*.

[5] The Court referred particularly to the conclusion below that there was a reorganization under Clause C. This was the only clause under which the court below found that there

is in conflict with the *Southwest* decision, and the Court's denial of certiorari leaves matters in a state of confusion. Although the court below purported to rest its decision also upon the alternative ground that the gain involved escaped taxation under Section 112 (b) (5), the application of those provisions is so highly doubtful as to call for clarification by this Court. It is not to be supposed that the reorganization provisions involved in the *Southwest Consolidated* case may be avoided by resort to Section 112 (b) (5). If the decision below is permitted to stand, the Government as well as taxpayers will be faced with the extraordinary result that although the old basis for the corporate assets will not carry over under the *Southwest Consolidated* case, taxation of the gain upon the exchange of the securities may nevertheless be avoided through Section 112 (b) (5). A result that is so incongruous should not be made to depend upon the inferences and conjectures surrounding the denial of a petition for certiorari.

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was a reorganization. The taxpayer has not urged the applicability of any other clause, and in its brief below, stated its agreement with our view that Clause A did not apply. See *Newton* v. *Commissioner*, 42 B. T. A. 473. It is obvious under the *Southwest decision*, that there could not be a reorganization here under Clause D or E; similarly there could not be one under Clause B because the new company issued both warrants and new bonds in addition to its common stock.

2. Every reorganization of any size is not only likely to produce a basis issue, but also is bound to produce numerous cases involving recognition of gain or loss upon the exchange of the securities by individual security holders. Denial of certiorari will mean that despite the Court's resolution of the basis issue, this corollary question must continue to be a subject of controversy and litigation. Heretofore, the uncertainty in this field has forced the Commissioner to take inconsistent positions in connection with these problems in order to protect the revenues. (See brief of the Government, *Helvering* v. *Southwest Consolidated Corp.*, pp. 10–11.) While we believe the decision below was erroneous, the Commissioner has no alternative, until the question is authoritatively determined, other than to continue the inconsistent practice of taxing gains and disallowing losses.

The question is pending at the present time in three different Circuit Courts of Appeals. In two instances, the Government is contending, as in the instant case, that gain must be recognized. *Commissioner* v. *Meyer Buchman* (C. C. A. 2d),* and *Commissioner* v. *Albert E. and May K. Schwabacher* (C. C. A. 9th). In the third case, the Government has contended that a loss should not be

* This case involves an exchange of securities in the same Section 77B proceeding as the instant case.

recognized. *Miller & Paine* v. *Commissioner* (C. C. A. 8th).[7]

Moreover, although we believe that the basis issue was resolved in the *Southwest Consolidated* case, denial of certiorari here will doubtless produce further litigation on that question which normally would have been avoided. Excuse will be found for advancing specious points of distinction in the necessity of reconciling the apparent inconsistency between that decision and the Court's disposition of the Government's petition here. The petition for rehearing, filed by the taxpayer in the *Southwest Consolidated* case, itself, provides examples. See pp. 2–3, 5.

3. The error of injecting Section 112 (b) (5) into this situation is not merely emphasized by the inconsistency it produces but is shown by the inapplicability of its language. Section 112 (b) (5) applies only to transfers of "property" to a corporation. It assumes the continuance of that property in the hands of the transferee.[8] Here, how-

[7] In each of the cases a stipulation was entered into, deferring the proceedings until after this Court's disposition of the instant case and the two *Newton* cases. *Commissioner of Internal Revenue* v. *James Q. Newton Trust*, and *Commissioner of Internal Revenue* v. *James Q. Newton, Jr.*, Nos. 645 and 646, respectively. The stipulations did not require either party to be bound by the Court's action, however, nor did they preclude either party from thereafter urging any other points that might be relevant.

[8] Cf. Section 113 (a) (8), providing the basis for "property" acquired by a corporation by the issuance of its stock or securities in connection with a transaction described in Section 112 (b) (5).

ever, the old bondholders, upon taking the new securities, surrendered their claims, and the obligations of the debtor companies were discharged. The bonds never existed as property in the hands of the new company. They were not transferred as such nor could they have constituted the consideration for the issuance of the securities of the new corporation. These securities, of course, were issued for the assets acquired from the old corporation* (R. 133–135, 138, 139, 168, 190–191).

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*Portland Oil Co. v. Commissioner, 109 F. (2d) 479 (C. C. A. 1st), certiorari denied, 310 U. S. 650, and A. Birren & Son v. Commissioner, 116 F. (2d) 718 (C. C. A. 7th), cited by the taxpayer as supporting the decisions below (Br. 4), each involved a transfer of an intangible to a corporation which received and held the intangible *as its property;* consequently, the two cases are plainly distinguishable.

On the other hand, the decision below, in applying Section 112 (b) (5), is thus inconsistent with *Fairbanks v. United States*, 306 U. S. 436, in which this Court held that the surrender of a bond for redemption did not constitute the sale or exchange of a capital asset. It is also inconsistent with the decisions holding that the surrender and cancellation of a secured claim, upon acquisition of the security, is not such a sale or exchange. *Bingham v. Commissioner*, 105 F. (2d) 971 (C. C. A. 2d); *Commissioner v. National Bank of Commerce*, 112 F. (2d) 946 (C. C. A. 5th); *Commissioner v. Spreckels*, 120 F. (2d) 517 (C. C. A. 9th); see *Commissioner v. Electro-Chemical E. Co.*, 110 F. (2d) 614, 616 (C. C. A. 2d), affirmed, 311 U. S. 513; cf. *Hale v. Helvering*, 85 F. (2d) 819 (App. D. C.). These cases turned on the ground that the surrender was not a transfer of property to the debtor.

It is respectfully submitted, therefore, that the order denying the petition for certiorari be vacated and that the petition be granted.

CHARLES FAHY,
Solicitor General.

I certify that this petition is presented in good faith and not for delay.

CHARLES FAHY,
Solicitor General.

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